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## Islamic Banking and Empowerment of Small Medium Enterprise

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### Abstract

*This study explores the effectiveness of developing SMEs with role of Islamic Banking in Indonesia. The study also want to prove the role of Islamic banking to help SMEs in Indonesia based on data and research. Data analysis and methods that used in this study is descriptive statistical methods. Descriptive statistics will elaborate with some explanation data and can be figured by frequency distribution and center of distribution data. The result shows that development of SMEs regarding both the number of business units, employment, and financing from Islamic banking indicates a positive direction or increased significantly. In addition, the interaction between SMEs and Islamic banking is quite close relatively but need to be upgraded. The study only gives general overview and description about positive impact from Islamic banking mechanism to stimulate SMEs in Indonesia. The data and result provided still need to be discussed with more comprehensive literature and fact study on the ground.*

**Keywords:** financial institution, Islamic banking, small and medium enterprise

### Abstrak

*Penelitian ini menganalisis bagaimana efektivitas pengembangan UKM dengan peran Perbankan Syariah di Indonesia. Studi ini juga ingin membuktikan peran perbankan syariah untuk membantu UKM di Indonesia berdasarkan data dan penelitian. Analisis data dan metode yang digunakan dalam penelitian ini adalah metode statistik deskriptif. Statistik deskriptif akan diuraikan dengan beberapa data penjelasan dan dapat dipikirkan dengan distribusi frekuensi pada pusat data distribusi. Hasilnya menunjukkan bahwa pengembangan UKM baik menyangkut jumlah unit usaha, lapangan kerja, dan pembiayaan dari perbankan syariah menunjukkan arah positif atau meningkat secara signifikan. Selain itu, interaksi antara UKM dan perbankan syariah cukup relatif dekat dan perlu ditingkatkan. Studi ini hanya memberikan ikhtisar dan gambaran umum tentang dampak positif dari mekanisme perbankan Islam untuk merangsang UKM di Indonesia. Data dan hasil yang diberikan masih perlu didiskusikan dengan literatur yang lebih komprehensif dan studi fakta di lapangan.*

**Kata kunci:** lembaga keuangan, perbankan syariah, usaha kecil dan menengah

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## INTRODUCTION

Islamic banking is one of the growing financial institutions in Indonesia as a manifestation of development it self and also development of Islamic economics. While SMEs constitute the backbone of many economies, many SMEs have limited access to finance. Yet, banks in some countries are actively financing SMEs (Aysan et. al., 2016).

Important note about the developments, opportunities, and problems of Islamic banking in Indonesia can be seen from some of the results of a study conducted by ADB's team (Noorjaya, 2001). Islamic banking particularly is a value-oriented ethical proposition that aims at socio-economic development as opposed to the financialization of the economy. In addition, Islamic banks, being the major Islamic financial institutions in the society, are duty bound to offer a wide range of products and services that will meet the needs of all segments of society and ensure that risks and rewards are shared fairly in society (Farook, 2007).

Meanwhile, the studies that describe the development of Islamic banking in Indonesia with a focus on "full power" in SMEs development had begun in 1992 (Riwajanti, 2013). This means that the full power of existence of Islamic banking at that time was started by a pretty good idea and it is easy to apply the rules of *Muamalah* (Islamic teaching in economics) in the middle of the economic vulnerability (capitalist and liberal). In terms, the majority of Islamic bank financing can be categorized as good quality financing (Seibel, 2005).

On the other hand, development of Islamic banking in Indonesia can be seen by identifying the potentials and the problems of Islamic banking in Indonesia (Seibel, 2005). Some of the potentials of Islamic banking are have loyal customers who are Muslims and spread all over Indonesia (this is supported by studies of Bank Indonesia), the financing of Islamic banking compared to emphasize the feasibility of collateral (unlike conventional banking), and has a magnet for investors from the Middle East and beyond. However, the problems of Islamic banking, among others, are the regulations of banking health analysis still equated with the regulations for conventional banking, the difficulty in obtaining suitable human resources needs of Islamic banking, Islamic banking network and infrastructure is still limited, and the public's understanding of Islamic banking are not maximized (attachment between the customer with Islamic banking has not been on family ties).

Generally, the financing gap in developing countries is even more severe, since financial institutions such as banks widely consider SMEs to be too risky due to such factors as lack of collateral and insufficient credit history. It's about 55-68 % of SMEs in developing countries are either financially underserved or not served at all. This indicates by the large number of micro enterprises was lessen their hidden potential which have relationship with economic sectors where mostly people have many activities.

Referring the development of Islamic banking, especially the importance of Islamic banking as well as carrying out of intermediary function, then the study will further examine the pattern and impact of Islamic banking to Small and Medium Enterprises (SMEs) development in Indonesia. Then, the issues need to have studied for finding solution in the future. The problem is "Does the development of Small and Medium Enterprises (SMEs) with Islamic banking in Indonesia can be realized positively?"

## METHOD

This study used secondary data include data on the number, employment, the contribution of financing (from Islamic Banking), and SMEs. Source data collected from Bank Indonesia (Statistics of Islamic Banking) and website of the Ministry of Cooperatives and SMEs. Frequency distribution is a group of data that show similarity category, the number of observations in each class. Calculation the frequency can be done by grouping the observations of the behavior in the sample based on a specific category. This method allows the observer to see the large and the frequency distribution of samples in each category. Observations of the frequency distribution can be done in discrete and continuous. The observations will be more easily identified by using tables and graphs. The steps in making a frequency distribution is: (a) Determining the intended question; (b) Collecting the raw data; (c) Organizing or classifying data (frequency distribution); (d) Showing the data (graph); (e) Making conclusions

Center of a distribution can be explained by using three tools: the mode, the middle value (median), and the average (mean). Mode is defined as the value that appears most frequently in the sample observations. Mode is the easiest way to obtain the size of a distribution center. However, the mode is not the best way to describe the size distribution center, because it greatly depends on the pattern of grouping data. The median or middle value can also be used as a way to obtain the size of a distribution center, but also highly dependent on the pattern of grouping data. Arithmetic average is the sum of sample values

divided by the number of samples. A measure that could explain the distribution center is the average (mean), because the average value does not depend on the pattern of grouping data. The average value obtained by summing all observations and share sample data with sample size ( $n$ ). The average deviation is the arithmetic average of the absolute price deviation from the arithmetic series.

## RESULT AND DISCUSSION

The position of Islamic banking in the development of SMEs in Indonesia has an important role (Amah, 2013; Bhakti, 2013). As we know, the business sectors of SMEs in general are intraditional sectors with unusual risk assessment available on conventional banking experience. Looking for another study, Islamic banking system provides another conviction that would be guarantee of security in their mind. The last thing is to strengthen their level of hope and confidence in case the success of his efforts. The Islamic bank financing can strengthen the performance of SMEs (Anggraini, et.al, 2013; Kara, 2013; Faisol, 2017).

Islamic economics is actually perfect for business that has high uncertainty and limited market information, especially if successfully built integration between security functions and business risk. Therefore, a range support for SMEs to closer with Islamic banking is very important and one strategy is how the integrity of the Islamic financial system can establish. That is what to look the answer. The integration of Islamic financial system is one of the important element in making the Islamic financial institution becomes effective, has a high benefit, especially in the context of globalization and regional independence.

As same as conventional systems in the Islamic financial system, there are also have small and medium players, including banking. Thus, cooperation and linkages between large-scale Islamic banking and small and medium-scale Islamic banking should get attention. Furthermore, that will be more productive if the role of Islamic financial institutions non-bank also received the same attention. From various data presented by Center Statistical Bureau (BPS), the financial services sector, leasing, and company services, is the most productive sector compared to other sectors, even no difference in the value added / labor between small and large financial institution.

With increased liberalization, Indonesia emerges as a country with a lot of economy support from micro, small, and medium enterprises. The majority of the number of

businesses in Indonesia is a micro business. Under the Act Number 20, 2008 on Micro, Small, and Medium Enterprises is known that micro-enterprise is a business with net worth amount of  $\leq$  Rp50 million and  $\leq$  Rp300 million in annual sales. Small business are business with a net worth of  $>$  Rp50 million –  $\leq$  Rp500 million, annual sales of  $>$  Rp300 million –  $\leq$  Rp2.5 billion. In other hand, the medium is a business with a net worth of  $\leq$  Rp500 million –  $\leq$  Rp10 billion, annual sales  $>$  Rp2.5 billion -  $\leq$  Rp5 billion. Within three decades, the development of SMEs units expanded from 15 % to 29 % of the overall sector in the country, which represents a huge prominent investment (BPS, 2015).

**Table 1. Number of Business Units by Type of Business Annual Year 2009 – 2010**

No	Business Unit (s)	Annual Year	
		2009	2010
1	Micro Business	50.349.236	51.227.653
2	Small Business	501.535	517.291
3	Medium Business	39.186	40.012
	Total Units of SMEs	50.438.557	51.784.956

Source: Ministry of Cooperative and SMEs, 2010

Table 1. provides information about development of the number of units in micro, small, and medium enterprises in the year 2009 – 2010. Based on these tables, it can be seen that the number of micro, small, and medium tends to increase. In total, the number of micro, small, and medium enterprises (SMEs) in 2009 as many as 50 million units and increase up to 51 million units in 2010. This progress is an indication that Indonesia's economy will be "sensitive" to the dynamics of the SMEs. Sensitive means changes that happen in SMEs will significantly direct impact on the economics condition of Indonesia.

Table 2 provides information about the number of SMEs in the field of business units in 2010. Based on these tables, it can be seen that the number of micro enterprises tend to be dominant in case of comparison with small and medium enterprises. It can look from the side of field business that the agricultural sector is dominant in providing opportunities for developing SMEs.

This can be looked further that the agricultural sector is possible at this point to become a mainstay of low-income communities in Indonesia. Low-income communities tend to be close for the poor people (Lin, 1998). This means that the special treatment of SMEs in the agricultural sector needs to be done in order to reduce the number of poor people in Indonesia. Other sector which also becomes the center of the development of SMEs is trade, hotels, and restaurants. This is quite reasonable because this sector either

directly or indirectly will interact with the agricultural sector. By looking at the development of this sector and this sector also as the foundation for the development of SMEs, it is to be seen again how big the SMEs employment.

**Table 2. Number of Business Units by Sector in 2010**

No	Sector	Micro Business	Small Business	Medium Business	Total SMEs
1	Agriculture, Forestry, and Fisheries	26.412.118	1.041	1.691	26.414.850
2	Mining	267.712	2.107	268	270.087
3	Manufacturing Industry	3.129.571	53.018	8.201	3.190.790
4	Electricity, Gas, and Water Supply	13.171	551	523	14.245
5	Building	158.883	12.617	1.854	173.354
6	Trade, Hotels and Restaurants	15.091.673	381.647	20.231	15.493.551
7	Transportation and Communication	3.101.281	17.420	1.424	3.120.125
8	Finance, Leasing and Business Services	911.273	23.365	3.991	938.629
9	Services	2.141.971	25.525	1.829	2.169.325
	Total	51.227.653	517.291	40.012	51.784.956

Source: BPS, 2010

The ability of the business or the economy to absorb labor force is one of the indicators of successful development in the business or the economy. By looking at employment data of SMEs in 2009 - 2010, published by Ministry of Cooperative and SMEs, it is known that the employment was carried out by SMEs tends to increase. This information can be seen in Table 3.

**Table 3. Employer Performance by Business Units Annual Year 2009 – 2010**

No	Business Units	Annual Year	
		2009	2010
1	Micro Business	82.332.452	84.125.531
2	Small Business	3.824.615	4.000.246
3	Medium Business	3.161.338	3.216.154
	Total Employees	89.318.405	91.341.931

Source: Ministry of Cooperative and SMEs, 2010

The increasing of contribution the amount of labor performed by SMEs means that this business will become one of the reliable to the Indonesian economy in case for empowering small business actor and nation's economic competitiveness facing the global economy and globalization. One of the toughest impacts is labor mobility between countries which approach until "perfect" level. So, active role from various institutions

necessary to make sustainable condition and enhance the SMEs from various aspects of business. One of the institutions is the role of banking (in this case is Islamic banking) in distribution of financing to SMEs.

Development of distribution or contribution in Islamic banking financing (Banks and Sharia Business) for SMEs during the years 2008 – 2010 tend to increase. This information can be seen in Table 4. Based on the Table 4, it can be seen that the allocation of financing for SMEs higher than financing non-SMEs.

**Table 4. Financing Performance in Islamic Banks and Sharia Business**

**Annual Year 2008 – 2010 (Million Rp.)**

<b>Sector</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>
SMEs	27.063	35.799	41.271
Non-SMEs	11.131	11.087	11.732
Total	38.195	46.886	53.003

Source: Bank Indonesia, 2010

Meanwhile, Table 5 describes the development financing in Islamic Financing Bank (BPRS) for SMEs in the year 2008 until 2010. Based on the table, it appears that the amount of BPRS funding to SMEs relatively bigger than financing to non-SMEs. Financial data contained in Table 3 and 4 give the indication that the alignments of Islamic banking to SMEs are no doubtful. This will be a positive signal about development of SMEs and syndicate of Islamic banking. Desired target of this syndication is creating a power of competitiveness in SMEs to facing global challenges.

**Table 5. Financing Performance of Islamic Financing Bank**

**Annual Year 2008 – 2010 (Million Rp.)**

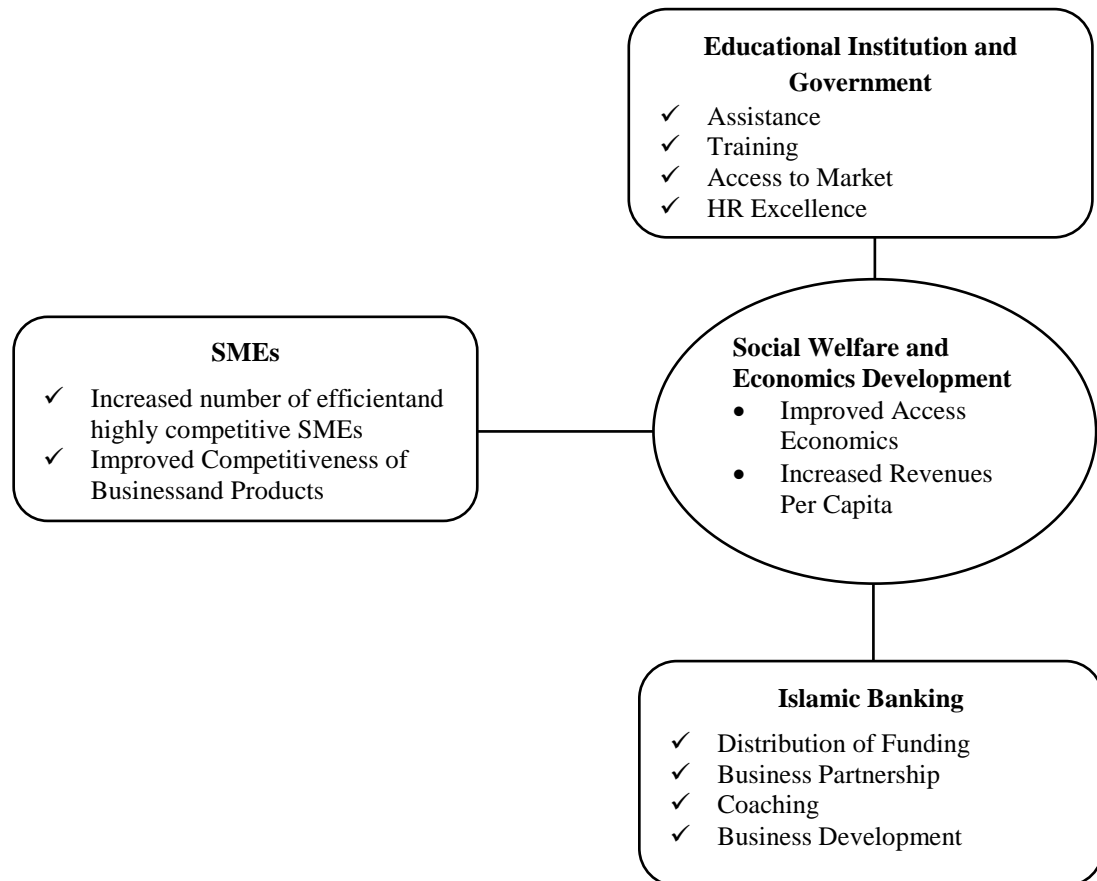
<b>Sector</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>
SMEs	657.359	833.076	1.004.163
Non-SMEs	599.291	753.843	820.141
Total	1.256.650	1.586.919	1.824.304

Source: Bank Indonesia, 2010

Integral development between Islamic banking and SMEs based on previous discussion can be focused and strengthened in order to increasing the bargaining power of SMEs in Indonesia. Thus Syndication involves many components and institution, but the key is SMEs and Islamic banking. With references from the Figure 1, it can be seen that the basic key (in this study) is the SMEs and Islamic banking. It needs to be done by the Islamic banking, Islamic financial institutions and their networks, is to establish mutually

beneficial business partnerships with SMEs. In addition, Islamic banks also need to hold coaching and business development for SMEs as their responsibility. In this study, it can be done by working with educational institutions and government (central and local).

**Figure 1.** Development Pattern of SMEs and Islamic Banking in Indonesia.



Source: Obaidullah and Khan (2008), re-formulated by the writer

Target of development activities in SMEs and Islamic banking is developing skills and increase competences and market values. If Islamic banking and SMEs can develop and make an integral, it will be able to give contribution of a lot of employee. Increasing number of workers absorbed will directly affect the least number of poor or even unemployment. Islamic banks could give direct funding to impact oriented real economic activities, it thus utilizes economic and financial resources to satisfy the material and social needs of all members of the community – including SMEs. All the channels are designed to be based on *Shari'ah* principles (*Shari'ah*-based) whereas a wide spectrum of different options can still considered. In addition, Islamic banks must be screened for every financial



initiatives on a case-by-case basis on business practices and transactions in compliance with *Shari'ah*.

## CONCLUSION

Conclusion based on the analysis is the development of SMEs regarding both the number of business units, employment and financing from Islamic banking indicates a positive direction or increased. In addition, from some of the existing table, the interaction between SMEs with Islamic banking is quite closely. It can be seen from allocation of financing for SMEs in comparison from non-SMEs is more dominant. To further enhance the role of empowerment of SMEs, synergy patterns between SMEs development and Islamic banking can be done well if there are have beneficial business partnership, development, and optimization of the network together. In this case, the educational institutions also have an important role to support the development of both of this institution.

SMEs and Islamic banking must establish cooperation partnership, coaching, and business development as an integral system. This effort can be supported by a network involving the Islamic financial institution owned by the Islamic banking. Cooperation partnerships, coaching, and business development will be able to have an impact on increasing employment in SMEs. Educational institutions will become a significant institution in the providing support and training of competent human resources. This means that educational institutions will change the mindset of the poor people into a society which can make more productive and competitive. Central and local governments are expected to integrate these programs with the development of SMEs, Islamic banking programs, and educational institutions.

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